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Abstract
After pressure from shareholder activists, proxy advisory firms, and the New York Stock Exchange, the Securities and Exchange Commission has eliminated uninstructed broker voting in director elections. We observe that average director approval rates remain high after the change in regulation, while the probability of a director being voted off the board remains low. In addition, we find no evidence of significant wealth effects of the change in regulation. We do find that firms are increasingly letting shareholders ratify their auditors after the change in regulation, which helps in establishing a quorum.

JEL classification: G34; G38

Keywords: Broker voting, shareholder empowerment, Securities and Exchange Commission, board effectiveness

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I. Introduction

On the 1st of July in 2009, the SEC approved a proposal by the New York Stock Exchange (NYSE) to ban broker votes from director elections to be effective from 2010.[1] Previously, brokers were allowed to cast votes in place of their clients in uncontested director elections if they had not received voting instructions from their clients prior to the annual meeting. Because brokers typically cast discretionary votes in favor of management (Bethel and Gillan, 2002), a number of outside parties, including shareholder activists, proxy advisory firms, and the NYSE, were putting pressure on the SEC for new regulation that eliminates uninstructed broker votes to create more accountable boards and to improve corporate governance. For example, the institutional investor CalPERS asked the SEC already in June 2007 to immediately eliminate uninstructed broker voting and subsequently expressed its disappointment at the SEC's failure to act on the issue.[2] Similarly, in 2009 the Council of Institutional Investors stated in a letter to the SEC that "this long overdue reform is needed now more than ever" and proxy advisor firms Glass Lewis and ISS were also strongly supporting the rule change.[3] In addition, the SEC was exposed to political pressure by the U.S. House of Representatives: During a hearing before the House Committee on Financial Services on June 26, 2007, Representative Watt asked then SEC Chairman Christopher Cox to present a timetable for the approval of the rule change and whether regulation would be in place by the next proxy season.[4]

The issue received intensive media coverage. In 2009, shortly before the rule change

[1] The final release by the SEC is available at http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf.

[2] Correspondence from CalPERS with the SEC can be found at http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692-7.pdf.

[3] See http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692.shtml. ISS demanded already in 2003 that broker votes be abolished (see http://sec.gov/rules/proposed/s71903/iss121803.htm).

[4] See http://www.shareholdercoalition.com/marketoversighthearingtranscript.pdf.

came into effect, the Financial Times (Goodman, 2009) noted that "directors need to take a deep breath because they are facing a fundamental shake-up in corporate governance," referring to the combined effect of the broker voting rule change and the increasing adoption of majority voting standards by firms. Already in 2007, the Wall Street Journal (Scannell, 2007) wrote that "investors … may soon get a boost, as the role of shareholder votes cast by brokers comes under closer scrutiny." One of the leading business law blogs suggested that the adoption of the amendment "is the biggest of the reforms that companies face - bigger than proxy access, say-on-pay, etc."[5]

The statements in the financial media might be exaggerations. Shareholder approval rates in uncontested director elections have historically been very high: Cai et al. (2009) show that approval rates for directors generally exceed 90%, even at underperforming firms. The exclusion of a relatively small percentage of votes – in our sample broker votes are on average 12% of the votes cast – seems unlikely to significantly change the outcomes of director elections, especially as the "in favor" discretionary votes by brokers are not likely to be replaced by "against votes," but by retail investors not voting at all. Opponents of the change in regulation have therefore argued that the main effect of the rule is to raise proxy solicitation costs, without providing any substantial advantages.

Ultimately, whether the change of broker voting regulation is beneficial to shareholders is an empirical question. We document the effect of the changed rule on voting outcomes for S&P 500 firms. In 2009, before the rule change came into effect, the average approval rate for directors is 93%. We calculate the synthetic approval rate in 2009 had broker votes been excluded. Following Cai et al. (2009), our computation proceeds on the assumption that brokers

[5] See *The Big Kahuna: SEC Approves NYSE's Elimination of Broker Discretionary Voting*, TheCorporateCounsel.net Blog, July 2, 2009.

cast their discretionary votes in favor of management and that investors who did not provide their broker with instructions in 2009 would not have voted if the rule change had been in place, or would have voted in a similar manner as other shareholders. We find that without broker votes, the average approval rate would have been 92% in 2009, which seems a very marginal decrease. The reason that an average of 12% of broker votes only leads to an average 1% decrease in approval rates is that broker votes will be excluded from both the numerator and the denominator: $\frac{93-12}{100-12}$ = 92%. More importantly, when examining actual election outcomes in 2010 and 2011, we find that the change in broker discretionary voting regulation has no significantly negative effect on director approval rates, and we find no increased probability that a particular director is voted off the board after the rule change. We estimate that on average only 14% of the non-instructing shareholders in 2009 vote in 2010.

Of course, it could be that the new regulation affects voting outcomes further in the future, or that the change in regulation is value relevant for firms in other ways, for example by improving the effort exercised by directors to act in shareholders' best interests. To examine the possibility that the change in regulation is value relevant for firms in other ways, we study the effect of the elimination of discretionary broker voting on shareholder value. The importance of this analysis follows from Cai et al. (2009), who provide evidence that voting behavior in uncontested elections can have significant effects on for example CEO compensation and turnover, even if it does not lead to the removal of directors. We examine shareholder wealth effects on nine key event dates during the regulatory process that led to the elimination of broker voting. In assessing the market response of the S&P 500 firms to the events, we consider two control groups, which are a global market index (from which we exclude U.S. stocks) and the returns of firms registered under the Investment Act of 1940. The latter type of firms were

exempted from the rule change due to an amendment filed by the NYSE with the SEC on May 27, 2007. We do not find overall wealth effects of the ban using either of the two benchmarks.

We further examine the possibility that the rule change is value relevant for a subset of firms in our sample. In a cross-sectional analysis we employ several proxies for the potential relevance of the rule change for firms. These proxies are the percentage of broker discretionary votes, average director approval rates, institutional ownership, whether or not the firm had a majority voting standard, the entrenchment index, return on assets, firm size, and industry competitiveness. We do not find convincing effects of these variables on abnormal returns. We also study firms with a relatively high number of shareholders that explicitly ask the SEC to eliminate broker votes. We find that shareholders of firms with more broker votes are more likely to express their preference for the elimination of broker votes, but we find no convincing evidence that firms have differential abnormal returns when more of their shareholders express support for the new rule. We further focus on a sample of 600 small cap stocks. Again, we find no convincing evidence that the rule change affects overall abnormal returns or voting behavior.

As the change in Rule 452 makes uncontested director elections a non-routine matter, broker discretionary votes will not count for a quorum if shareholders can only vote on the election of directors. The rule change therefore complicates reaching a quorum. However, Rule 452 does allow broker discretionary voting on routine matters, such as the ratification of independent auditors. We find that firms have increased the number of items on the ballot since 2009. In fact, the percentage of firms with auditor ratification on their ballot after the change in regulation is 99%, which mitigates any difficulties caused by Rule 452 to obtain a quorum.

Our results raise questions about the role that different actors play in the initiation and adoption of regulation. Many market participants, notably shareholder activists and proxy advi-

sory firms, strongly supported the rule change from its beginning and exerted pressure on the SEC to adopt it. The rule's apparent futility suggests that it may be of interest to study in more detail the incentives and potential biases in decision making within these organizations regarding regulation. Rather than being unbiased agents for shareholders, these institutions may have incentives to pursue or advocate policies to enhance their own public visibility or perceived disciplinary role. Belinfanti (2009) argues that proxy advisory firms do not have appropriate incentives to act in the best interest of investors because they benefit from high barriers to entry in the proxy advisory market and bear no risk from providing bad recommendations. McCall (2011) stresses the possibility that proxy advisory firms respond to incentives such as the generation of consulting revenue and to demonstrate vigilance to subscribers and politicians. A desire of proxy advisory firms and shareholder activists to demonstrate vigilance could explain why they strongly support changes in regulation, even if these are likely to be ineffective.

Our results also raise the question to what extent the SEC's actions are distorted by outside pressure, which relates to the political-economy approach to financial regulation that attempts to provide a positive analysis of the evolution of regulations (see Kroszner, 2000). Our findings suggest that it is interesting to open the black box of the SEC and examine more closely its motivations in the design of governance regulation. This topic has not received much attention in the corporate governance literature. A notable exception is Choi et al. (2012), who provide evidence that the SEC may have misallocated enforcement resources to less efficient investigative activities due to news coverage and media frenzy on option backdating. Their results raise the question how the media, in turn, allocates its attention and resources and which distortion may arise in this context. In a time when the SEC and its supporters recurrently complain about

the lack of resources devoted by Congress to the SEC's mission of investor protection,[6] evidence on the effectiveness of SEC regulation is of the highest importance.

The remainder of this paper is organized as follows. Section II discusses regulation of broker discretionary voting and Section III outlines our hypotheses. Section IV describes the data and presents descriptive statistics. Section V presents the empirical results related to voting outcomes, whereas Sections VI and VII focus on wealth effects. Section VIII concludes.

II. Broker Voting and Changes in Regulation

Shareholders can hold shares in a company in two different ways, either directly, as the record holder, or indirectly, through their broker or bank. In the latter case, the shareholder is referred to as the beneficial holder and the broker is said to hold the securities in "street name." This distinction plays an important role for voting at annual shareholder meetings. Rule 452 of the New York Stock Exchange allows brokers to cast votes on behalf of their shareholders on "routine" proposals under the condition that they have not received voting instructions from their clients.[7] These discretionary votes are often referred to as "broker votes." Historically, broker votes tend to be cast in favor of management proposals (Bethel and Gillan, 2002).

For many years, the uncontested election of directors was considered to be a "routine" matter by the NYSE. This changed on July 1, 2009, when the SEC approved a NYSE rule change that made uncontested director elections a "non-routine" matter, thus eliminating broker votes in all director elections. The rule change became effective for annual meetings on or after

[6] See, for instance, the recent article *SEC's Schapiro Rings Alarm about Budget Woes* in the Wall Street Journal (Holzer, 2011).

[7] NYSE Rule 452 lists a plethora of "non-routine" matters on which brokers cannot vote in the absence of instructions from clients such as contested director elections and proposals related to a merger or consolidation.

January 1, 2010. Companies registered under the Investment Company Act of 1940 were exempted.

We identify 9 events relevant to changes in the regulation of broker voting. Following Schipper and Thompson (1983), we define an event as one that either significantly changes the market's expectation of likely outcomes or alters the market's expectation of a specific outcome.

Our first event corresponds to regulation of broker voting garnering attention in 2003. According to a detailed article in the Wall Street Journal (Plitch, 2003) on July 30, 2003 (event #1), the issue of broker voting has "landed on the Securities and Exchange Commission's radar screen."

On November 17, 2004 (event #2), Dow Jones Newswires (Plitch, 2004) reports that the NYSE is considering a reform of its proxy voting system. According to the article, the exchange was considering creating a working group to revisit its broker voting rule. The rule had attracted much public attention and criticism in connection with the director election at the 2004 annual meeting of Walt Disney. Despite of a high profile "vote no" campaign by pension fund CalPERS, proxy adviser Institutional Shareholder Services (ISS) and other shareholders, the CEO of Disney, Michael Eisner, was reelected to the board with 55% of the votes cast. In the view of many commenters, Mr. Eisner would have only received 45% of the votes and failed to garner a majority if broker votes had been disallowed.

In April 2005 the NYSE established the Proxy Working Group (PWG) with the mandate to review the exchange's proxy voting process in general and in particular Rule 452 on broker voting. Because the NYSE rule on broker voting is a member rule, a rule change would affect not only companies listed on the NYSE, but also companies whose stock is held for customers by member firm broker-dealers. The Proxy Working Group was composed of members from various

NYSE constituencies – including representatives from listed companies, institutional investors, lawyers and NYSE member organizations – and held its first meeting on April 25, 2005 (event #3).

The Working Group published a report on June 5, 2006 (event #4), recommending that the NYSE amend Rule 452 to make the election of directors a "non-routine" matter, thus eliminating broker votes in director elections.[8] The report explains that "directors are simply too important to the corporation for their election to ever be considered routine." The publication of the report was seen by the media as an important indication that a rule change might occur.[9] The report also included several other recommendations. The Working Group advised the NYSE to undertake significant effort to further educate investors about the importance of voting and to improve the ability of issuers to communicate with shareholders. These measures were considered to be a crucial complement to the elimination of the broker vote. For example, with regard to investor education the report noted that "any plan to amend Rule 452 ... must include as a critical component a large scale education effort to inform shareholders about the mechanics of the proxy voting process."

On October 24, 2006 (event #5), the board of the NYSE adopted the recommendations of its Working Group and filed a proposed rule change with the SEC to amend Rule 452 to eliminate broker discretionary voting for the election of directors.[10] The exchange asked for the amendment to go into effect for annual meetings held on or after January 1, 2008. The filing was

[8] The Working Group Report is available at: http://www.nyse.com/pdfs/REVISED_NYSE_Report_6_5_06.pdf.

[9] An article in the Wall Street Journal (Plitch, 2006) states: "If the past is any guide, the NYSE's decision to publish an advisory group's report is likely to lead to a rule change."

[10] In the following years the initial proposal was amended four times. Notably, on May 23, 2007, the exchange filed an amendment to exempt companies registered under the Investment Company Act of 1940 from the rule change.

widely reported as a step towards the elimination of broker voting.[11] On this occasion, the Chairman of the Working Group, Larry Sonsini, exhorted the NYSE to act on the Group's other proposals as well: "The amendment to Rule 452 should not be viewed in a vacuum. It is critical that the other recommendations of my Committee be implemented, particularly in the areas of investor education … and with respect to the ability of issuers to communicate with the beneficial owner of the shares."

In the following year, the reform process slowed down. Dow Jones Newswire (Whitehouse, 2007) reported on September 27, 2007 (event #6) that the NYSE had put on hold any plans to eliminate the broker vote. The day before, the NYSE had sent a letter to listed companies informing them that the rule change has been delayed by the SEC and will not become effective for the 2008 proxy season: "Based on recent conversations with SEC staff members, we learned that our proposed rule filing is being considered by the Commission as part of a broader range of issues relating to shareholder communications and proxy access. As a result, our rule filing will not be approved for the 2008 proxy season."

On May 21, 2008 (event #7), a detailed article on Dow Jones Newswire (Burns, 2008) reported that the elimination of broker voting seems to be "stuck at the SEC." A vice president with the Society of Corporate Secretaries and Governance Professionals is quoted with the prediction that the NYSE proposal "may die." The article also quotes Charles Elson, director of the Weinberg Center for Corporate Governance, who believes that the 2008 Presidential election could keep the SEC sidelined until a new President names a new SEC chair: "I think we're in one giant holding pattern. Come February or March of next year, it may be a different situation."

The situation indeed changed after Mary Schapiro was appointed by President Barack

[11] See, for instance, *NYSE Moves to Bar Broker Votes in Board Elections*, Associated Press (Oct. 24, 2006); *NYSE Moves to End Broker Voting for Directors*, Reuters (Oct. 24, 2006).

Obama as SEC Chairperson in the beginning of 2009, when the SEC published the proposed rule change for comment on February 26, 2009 (event #8).[12] The Commission received 153 comment letters. On the one hand, explicit support was expressed by many activist investors and proxy advisory firms, e.g. CalPERS, TIAA-CREF, and Glass Lewis. On the other hand, opposition mainly came from the representatives of listed companies.[13]

On July 1, 2009 (event #9), the rule was approved by the SEC and became effective for annual meetings on or after January 1, 2010. The proposal received the support of the three Democratic members of the Commission, while the two Republican members opposed it. [14]

[Table I here]

III. Hypotheses

We distinguish three hypotheses about the effect of the elimination of broker voting on voting outcomes and shareholder value.

Our first hypothesis is based on the SEC pursuing the rule for reasons other than the maximization of investor welfare. Choi et al. (2012) argue that the SEC pursued more marginal cases of option backdating over time, after the practice received considerable media attention. They find that later SEC backdating investigations are less likely to be accompanied by parallel criminal investigations and more likely to be terminated without producing monetary penalties, and they conclude that scandal-driven media attention led the SEC to move away from non-

[12] The SEC's notice of filing of the proposed rule change is available at: http://www.sec.gov/rules/sro/nyse/2009/34-59464.pdf.

[13] For all comment letters on the proposed rule, see http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692.shtml.

[14] The SEC consists of five Commissioners who are appointed by the President of the United States. By law, no more than three members can be from the same political party.

option backdating related accounting issues. Macey (2008) is also critical about the SEC, arguing that it has no meaningful market incentives to implement corporate governance rules that maximize shareholder value, but does have incentives to protect its turf and increase its budgets. The budget of the SEC is funded through annual appropriations enacted by Congress and the President and it can vary significantly from year to year.[15] For instance, the budget was nearly doubled from 2001 to 2004 following the governance scandals at Enron, Worldcom and others. This dependency may give considerable influence over regulation to the preferences or ideologies of legislative majorities or the interests of their constituencies. A potential politicization of the regulatory process is suggested by the voting behavior of the Commission's members. In absence of unanimity, the different members frequently vote along political party lines. According to Jeff Morgan, President of the National Investor Relations Institute, the heightened politicization of financial regulators will lead to "3-2 voting becoming a trend for the Schapiro-led SEC as it appears Commissioners are lining up with party affiliation with the three Democratic Commissioners having the majority vote."[16]

Following the above arguments, and given that director approval rates are historically very high at uncontested director elections (Cai et al., 2009), our first hypothesis is that the elimination of broker voting has no discernible effects on voting outcomes and firm value. Even if the ban led to a change in voting behavior and to greater director accountability, the impact may have been too modest to result in a change in firm values. After all, only uncontested elections are affected, which are by definition limited in the degree to which they can improve governance.

[15] See the SEC Strategic Plan for Fiscal Years 2010-2015, p. 8

[16] See http://www.niri.org/Main-Menu-Category/advocate/Presidents-Note/Schapiro-Leadership-Shuffle.aspx

Our second hypothesis predicts positive wealth effects. Proponents of the rule change argue that the elimination of broker votes makes boards of directors more accountable to shareholders. In turn, greater director accountability and better corporate governance should mitigate the agency costs that arise due to the separation of ownership and control and should thus add value to public corporations (Bebchuk, 2005). Starting point of the argument is the observation that brokers, unlike shareholders, have no economic interest in the companies in which they cast discretionary votes. Hence, they cannot be expected to act in the best interest of shareholders. Indeed, the fact that brokers generally vote with management is seen as evidence of a distorted election process that fails to hold directors accountable. Under the second hypothesis, the elimination of broker votes leads to more competitive elections that can increase firm value by strengthening directors' incentives to monitor their firm and to get involved with management.[17]

Our third hypothesis is based on several theories that suggest that empowering shareholders through stronger voting rights may in fact reduce the value of the firm. These papers share the basic idea that managerial discretion can be beneficial and that too much influence by outside investors is undesirable. For example, Burkart et al. (1997) argue that managers have stronger incentives to show initiative and to exert effort when shareholders' influence is restricted. If outside investors have too much power, they cannot commit to reward the manager through private benefits. Similarly, Almazan and Suarez (2003) propose that a weak

[17] In particular, an undistorted election system may result in closer monitoring because it reinforces the reputational concerns of directors (Fama and Jensen, 1983). For instance, board members may be more willing to curb excessive CEO pay if they are rewarded in a visible manner through higher approval rates at the annual meeting. See Adams et al. (2010) for a comprehensive survey of studies on board of directors. In addition to the incentive channel, the rule change might enhance performance by facilitating the removal or blocking of unsuitable or incompetent directors, notably in firms with majority voting standards. These considerations are echoed in letters sent to the SEC by market participants during the comment period. For instance, the Council of Institutional Investors notes that “uninstructed broker votes distort elections” and that “broker voting often masks significant shareowner dissatisfaction.”

board can be desirable because it allows investors to commit to a more lenient firing policy. This strengthens the manager's incentives to invest in firm-specific human capital. Adams and Ferreira (2007) explore the idea that close board monitoring might be costly, because it compromises the advisory role of the board. Akyol et al. (2012) and Larcker et al. (2011) study the wealth effects of attempts by the SEC to facilitate shareholder proxy access and find a negative effect on shareholder wealth. In our context, these theories suggest that the elimination of broker votes may be costly for shareholders.[18] In addition to these agency-based considerations, the rule change might be value reducing because it increases the proxy solicitation costs for companies since it forces them to devote more resources to communicating with shareholders and to soliciting votes in order to obtain a quorum.

IV. Data and Summary Statistics

Our sample consists of firms that are part of the S&P 500 stock market index at the end of 2009. We require these 500 firms to report their industry classification, firm size and return on assets in Compustat, their stock returns in CRSP, their institutional holdings in Thomson Reuters' 13F filings database, their voting standard for director elections and their anti-takeover provisions in RiskMetrics, and their voting results for director elections in the company filings database of SEC Edgar.[19] This leaves us with a sample of 457 firms.

[18] This concern was also expressed in many comment letters to the SEC. For example, the law firm Wachtell, Lipton, Rosen & Katz writes that "the proposed NYSE rule change is likely to magnify the already significant influence of institutional investors, activist shareholders and proxy solicitation firms, further constraining boards of directors from exercising independent business judgment on behalf of all shareholders."

[19] In 2009, the voting results typically appear in the first 10-Q filing after the annual meeting. For the years 2010 and 2011, the voting results can typically be found in Section 5.07 of the 8-K filings. We search for filings until 31-8-2011.

[Table II here]

Table II reports descriptive statistics of the firms in our sample for the 2009 fiscal year. On average, the aggregate number of shareholder votes at the annual meeting is 554 million votes per firm. The percentage of broker discretionary votes is the number of broker discretionary votes divided by total votes cast. When we are unable to find the number of broker discretionary votes in 2009, we use the number of non-instructing shareholders in 2010.[20] We find that, on average, broker discretionary votes represent 12% of the votes cast. The maximum percentage of broker discretionary votes in 2009 is 44% and belongs to Citigroup.

The approval rate is the percentage of votes that is cast in favor of a particular director. We divide the number of shares voted in favor by the total number of votes cast, which includes withheld votes.[21] We calculate the average approval rate per firm. Because the change in Rule 452 had not been in effect in 2009, broker discretionary votes are included in the reported approval rate. We find that the average approval rate per company in 2009 is 93%, with a minimum of 49% and a maximum of 100%.

We also calculate the *synthetic* approval rates for 2009, which reflects the estimated approval rate of a firm had broker votes been excluded. Following Cai et al. (2009), we adjust both the numerator and the denominator, and calculate the synthetic approval rate in 2009 as:

[20] The number of broker discretionary votes can be missing, even when we are able to locate the overall voting results, because firms are not required to report the number of discretionary broker votes when all items on the ballot are "routine" matters. Since uncontested director elections were considered "routine" in 2009, a limited number of firms only had routine matters on the 2009 ballot and hence do not report the number of broker discretionary votes. When we obtain the number of non-instructing shareholders ("broker non-votes") from 2010, we calculate the percentage of broker discretionary votes by dividing the number of non-instructing shareholders in 2010 by the sum of total votes cast and the number of non-instructing shareholders in that year.

[21] When a vote is withheld, a shareholder explicitly marks a proxy card as "withheld" for a particular director. Including withheld votes in calculating approval rates is in line with the measure most companies use to decide and report election results (see, for example, Cai et al., 2009).

$$\text{synthetic approval rate} = \frac{(\text{average approval rate x votes cast}) - \text{broker discr. votes}}{\text{votes cast} - \text{broker discretionary votes}}. \quad (1)$$

We find that the average synthetic approval rate for 2009 is about 92%.

The synthetic decrease in approval rate is the difference between the actual average approval rate for a firm in 2009 and the synthetic approval rate in 2009 for that firm. The average synthetic decrease in approval rates is only about 1 percentage point. The maximum synthetic decrease in approval rate is 11% for the directors of Citigroup in 2009, and would indicate an average approval rate of 75% rather than 86%.

Table II also reports general firm characteristics. Firm size is the size of total assets, reported in millions of dollars. Return on assets is calculated as the ratio of operating income before depreciation to total assets. It can be seen that the typical firm in our sample has total assets of about $12 billion and a return on assets of 11.8%. For our measure of institutional ownership we use the 13F filings database, which provides institutional holdings for institutional investment managers who exercise investment discretion over $100 million or more. We obtain a firm's institutional ownership by dividing the sum of the shares held by institutional investment managers by total shares outstanding at the 2009 fiscal year-end. On average, institutions hold about 85% of our firms' shares.

The entrenchment index, which is proposed by Bebchuk et al. (2009), counts the number of provisions a firm has out of the following six: staggered boards, limits to shareholder bylaw amendments, limits to amend charter, poison pills, golden parachutes, and supermajority requirements for mergers. We obtain the information from RiskMetrics and find that the typical firm in our sample has three of these provisions in place. Some firms have all provisions in place, indicating high managerial entrenchment, while other firms use none of these provisions and have low managerial entrenchment. The Herfindahl-Hirschman index is the sum of the squared

market shares of firms based on total sales and three-digit SIC codes, and is a measure of industry competitiveness. The average Herfindahl-Hirschman index score for the firms in our sample is 0.187.

We further construct a variable representing the voting standard that firms have for director elections. One voting standard is a plurality standard, in which directors receiving the largest number of votes are elected. Under a plurality standard, a director can be selected with one single shareholder vote in an uncontested election. An alternative voting system gaining popularity in the wake of SOX is a majority voting standard (see Cai et al., 2010), in which directors are elected if they receive more than 50% of the votes. A third voting standard, introduced by Pfizer in 2005, combines a plurality voting standard with a resignation policy. Under this standard, directors that do not obtain a majority are required to tender their resignation. The board (usually by a committee of independent directors) will then decide whether to accept the resignation or whether to take some other action appropriately responsive to the shareholder vote.

Our majority voting variable equals one for a majority voting standard, zero for a plurality voting standard, and 0.5 for a plurality-plus-resignation voting standard. In our sample, 271 firms have a majority voting standard in 2009, while 64 firms have a plurality standard that includes a director resignation policy. The remaining 122 firms have a plurality standard without a director resignation policy, which leads our majority voting variable to have an average of 0.663 (i.e. $\frac{271 \text{ x } 1 + 64 \text{ x } 0.5 + 122 \text{ x } 0}{457}$).

V. Voting Outcomes

In this section we examine the actual voting outcomes after Rule 452 has been in effect.

Although we already calculated the synthetic change in voting outcomes, the actual change in voting outcomes after 2009 might be different for several reasons. First, shareholders might have increased the attention they pay to director elections as the change in Rule 452 has increased the impact of one vote. Second, directors might have changed their behavior. The change in Rule 452 empowers shareholders in the director election process, and directors might have increased their efforts to act in the best interest of shareholders. Third, the voting outcomes of the 2009 annual meetings are likely to have been affected by the loss in shareholder value during the year preceding the annual meeting, in which the world went through a global financial crisis.

We collect voting outcomes after the change in Rule 452 by examining company filings in the SEC Edgar database for the annual meetings during 2010 and 2011. We search until 31-8-2011, i.e. we do not have the voting outcomes for firms that hold their annual meeting in the third or fourth quarter of 2011. We only consider firms for which we could find voting outcomes for all of the years 2009, 2010, and 2011, which are 407 firms.

[Table III here]

Panel A of Table III compares the voting outcomes in 2009 with those in the years 2010 and 2011. The average approval rate of the 407 firms' directors on the ballot is 92.8% in 2009, 94.9% in 2010, and 95.2% in 2011. Hence, we observe no decrease in approval rates after the change in Rule 452. In fact, the increase in approval rates in annual meetings after 2009 is statistically significant at the 1% level. A first likely explanation for this increase is that the financial crisis had put pressure on the results of many companies in the year prior to the 2009 annual meeting, which is likely to have reduced shareholders' approval of the directors and their

strategies. A second, non-mutually exclusive explanation could be that directors have increased their attempts to create shareholder value after the change in Rule 452. Of course, it has to be noted that the economic significance of the difference in approval rates between 2009 and 2010-2011 is relatively small. Average director approval is very high both before and after the change in Rule 452.

There are several directors that would probably not have obtained a majority of votes if broker discretionary votes had not been counted in 2009. For example, James Prowse and Scott Romney of Compuware Corporation received about 116 million votes in favor of their election during the 2009 uncontested director election, out of 206 million votes cast. Because there were 32 million discretionary broker votes, and assuming these were all cast in favor of the directors, the approval rate after the change in Rule 452 would have been $\frac{116-32}{206-32} = 48\%$. We therefore examine whether the number of directors failing to obtain a majority of votes has increased after Rule 452 has been in effect. Table III shows that in each year, shareholders vote on about eight directors per firm. About half a percent of the directors being voted on in 2009 receive a minority of votes (12 directors in total). During the 2010 and 2011 annual meetings, this percentage is even lower (0.019% and 0.386%, respectively). Apparently, it is very rare for a director to be voted down irrespective of broker discretionary votes being excluded.

The average number of votes cast decreases from 537 million in 2009 to 495 million in 2010. This decrease seems substantial, but the difference between 2009 and 2010-2011 is not statistically significant. To provide more information on the effect of the rule change on the number of votes cast, we construct a variable representing the estimated percentage of shareholders that transfer from being non-instructing to being instructing after the rule change. We construct this variable per firm as

$\frac{broker\ votes\ in\ 2009\ x\ \frac{shares\ outstanding\ in\ 2010}{shares\ outstanding\ in\ 2009} - non\ instructing\ shareholders\ in\ 2010}{broker\ votes\ in\ 2009\ x\ \frac{shares\ outstanding\ in\ 2010}{shares\ outstanding\ in\ 2009}}$. That is, we calculate the difference between the expected number of broker votes in 2010 when the rule would not have been changed and the actual number of non-instructing shareholders in 2010, and we divide this by the expected number of broker votes in 2010 when the rule would not have been changed.[22] If all non-instructing shareholders in 2009 decide to vote after the rule change, then non-instructing shareholders in 2010 equals zero and we obtain a percentage of 100%. If the rule change did not increase the propensity to vote for non-instructing shareholders, we obtain a 0% outcome. If we find an estimate of 10%, then this indicates that 10% of the shareholders who would have been classified as non-instructing before the rule change, while controlling for overall number of shares outstanding, would actually vote after the rule change. Figure 1 shows a histogram of the percentage of otherwise non-instructing shareholders that do vote in 2010.

[Figure 1 here]

If all non-instructing shareholders from 2009 would vote in 2010, we expect to see many observations in the 100% bin. Instead, we observe that more than 60% of the observations cluster close to the 20% bin, indicating that in those firms about 20% of the non-instructing shareholders in 2009 vote on uncontested director elections in 2010. Although there is noise in the analysis, with some observations below 0%, the results suggest that non-instructing shareholders who were represented by the broker vote in 2009 are not highly likely to cast their votes in 2010. The average (median) percentage of non-instructing shareholders in 2009 that do vote in 2010 is 14%

[22] Even though broker votes in uncontested director elections had been eliminated after 2009, firms have kept reporting the number of shareholders who do not provide voting instructions to their brokers.

(15%).

Panel B of Table III examines changes in the frequency of vote no campaigns. A vote no campaign occurs when an activist investor or proxy advisory firm recommends that fellow shareholders vote against one or more directors at the annual meeting. Del Guercio et al. (2008) provide evidence that this type of activism can improve firm performance and corporate governance.[23] The elimination of broker voting could facilitate the waging of such campaigns. In our sample, vote no campaigns occur at three firms in 2009, at seven firms in 2010, and at one firm in 2011. Hence, there is an increase in the first year after the rule change and a drop thereafter. One possible explanation for the decline in 2011 might be the concurrent increase in advisory votes on executive compensation that gave shareholders an alternative, more targeted, channel to express any potential dissatisfaction with directors. Overall, however, the probability of a vote no campaign being initiated is relatively low, and there is no statistically significant difference in the probability of a vote no campaign before and after the rule change.

Several comment letters indicate that the proposed NYSE Rule 452 complicates reaching a quorum. As the change in Rule 452 makes uncontested director elections a non-routine matter, broker discretionary votes will not count for a quorum if shareholders can only vote on the election of directors. A comment letter by Astoria Financial notes that "for many public companies, broker voting remains the most efficient means to obtain a quorum for shareholder meetings." A comment letter by BB&T states that because of the change "we would be forced to hire a proxy solicitor to solicit sufficient votes to establish a quorum at each shareholder meeting, including those with only proposals that historically have been considered non-controversial. Engaging a proxy solicitor generates a considerable expense that is ultimately borne by our

[23] See Ertimur et al. (2011) for the effectiveness of vote no campaigns related to executive pay.

shareholders. In today's difficult economic environment I believe that these expenses should not be taken lightly, even for large companies." NYSE Rule 452 does allow broker discretionary voting on routine matters, such as the ratification of independent auditors. In line with this observation, Glass Lewis & Co state in their comment letter that "we believe companies can resolve [achieving quorum without relying on broker votes for director elections] by providing shareholders a vote on another routine voting item such as ratification of auditors." To examine whether companies are now more likely to provide shareholders a vote on auditor ratification, we collect the items on the ballot from the company filings in SEC Edgar. Panel C shows the results. The number of items on the ballot has increased since 2009. However, most companies in our sample did already have an additional routine matter (next to uncontested director elections) on the ballot in 2009. After 2009, the auditor ratification is on the ballot for 99% of the firms in our sample.

Of the 407 firms in our sample, 179 firms have a classified board at some point during the period 2009-2011. With a classified board, shareholders can only vote on a fraction (typically one third) of the members of a board of directors in a single year. Consequently, comparing voting outcomes over the years is more informative for firms without classified boards. As a robustness test, we examine voting outcomes for the 228 firms that did not have a classified board at any point during the period 2009-2011. Panel D of Table III shows the results.

It can be seen that for firms without classified boards, the average number of directors that can be voted on is 11. We find that approval rates are also high for firms without classified boards. We observe an approval rate of 93.9% in 2009, 95.4% in 2010, and 95.8% in 2011.

VI. Market Response to the Adjustments in Rule 452

Although voting outcomes in 2010 and 2011 do not seem to be strongly affected by the rule change, the possibility remains that the new regulation affects voting outcomes further in the future, or that the change in regulation is value relevant for firms in other ways, for example by improving the effort exercised by directors to act in shareholders' best interests. To examine these possibilities, we study the effect of the elimination of discretionary broker voting in uncontested director elections on shareholder value.

NYSE Rule 452 is a member rule, which implies that a rule change applies not only to companies listed on the NYSE, but also to companies whose stock is held for customers by member firm broker-dealers. As a result, virtually every listed U.S. firm is affected by Rule 452, which requires careful thinking about selecting a control group. We construct two control groups to examine the wealth effects for firms affected by Rule 452. First, we follow Zhang (2007) and Akyol et al. (2012) by using a global market index that excludes U.S. stocks. Overall correlation between the global market index and U.S. market returns is high, and an abnormal return for the U.S. portfolio compared to the world index on Rule 452 event days can provide insight into the wealth effects of Rule 452. As our second benchmark, for events occurring after May 23, 2007, we use the returns of firms registered under the Investment Act of 1940. After an amendment of Rule 452 on May 23, 2007, it was completely clear that firms registered under the Investment Act of 1940 would be exempt from the change in Rule 452.[24]

To account for the cross-sectional correlation in stock return residuals due to each event occurring on the same calendar date for all affected firms, we use a version of the event study

[24]Akyol et al. (2012) also use the Canadian stock market index as a benchmark index. Canadian firms are not an appropriate control group for Rule 452, since meetings of both U.S. and Canadian reporting issuers have been marked by the NYSE as eligible for discretionary voting under Rule 452 (Lando, 2009). The change in Rule 452 will not affect other foreign private issuers because they were not historically eligible for discretionary voting under Rule 452.

methodology of Schipper and Thompson (1983). In this model, the dependent variable is the return on a portfolio *p* consisting of the 457 stocks in our sample:

$$r_{pt} = \beta_0 + \beta_1 r_{m,t} + \sum_{e=1}^{E} \gamma_{pe} D_e + \varepsilon_{pt}, \qquad (2)$$

where r_{pt} is the day *t* return on the equally-weighted portfolio *p;* $r_{m,t}$ is the contemporaneous return of the control group; and ε_{pt} is the error term. D_e is a dummy variable equal to one for any event *e* that increases the probability of disallowing broker discretionary voting for uncontested director elections, equal to minus one for any event *e* that decreases this probability, and equal to zero otherwise.

We obtain firms' stock returns from CRSP and obtain the times series data of the Dow Jones Global ex-U.S. Composite Index from Reuters. We estimate the Schipper and Thompson model for the period from July 30, 2002 until July 31, 2009. Our main event window is [-1, 1]. Table IV shows the results.

[Table IV here]

Panel A shows the overall wealth effects when using the global index. For the global index, we modify the Schipper and Thompson (1983) specification by including lead and lagged market returns, which overcomes the potential bias that follows from non-synchronous trading due to time differences between countries in our global market index.

It can be seen from the estimation results in Panel A of Table IV that the overall reaction to the change in Rule 452 is not statistically significant when we use the global index as our control group. The coefficient of the daily abnormal return is close to zero and the *p*-value is 0.804. To examine the wealth effects in more detail, Panel B of Table IV reports the abnormal

returns for our sample firms per event. In Panel B, D_e equals one for one particular event at a time. We indicate whether an individual event increases or decreases the probability of a rule change by using the information in Table I. We find that there is no statistically significant abnormal return for our sample firms on any of the nine event days when we use the global index as a benchmark. Furthermore, the signs of the coefficients are not very consistent. For the seven events that increase the probability that Rule 452 will be modified, we find four events with a positive sign and three events with a negative sign.

In March 2007, the Securities Industry and Financial Markets Association (SIFMA) sent a letter to its members in which it encourages brokers that do not receive voting instructions from some customers to vote those customers' shares in proportion to the voting instructions the broker receives from its other customers, a practice known as proportional voting. As a result, various large brokerage firms, like Schwab, Ameritrade, Morgan Stanley, Merrill Lynch and Goldman Sachs had moved to proportional voting before the 2009 proxy season (Sanati, 2009). Because the implementation of proportional voting is likely to reduce the impact of Rule 452, Panel C examines the combined wealth effects of events before and after March 2007. We find that there are no significant wealth effects of changes in regulation in broker discretionary voting, even when brokers had not yet moved to proportional voting.

In Panel D of Table IV we use the equally-weighted returns of a sample of 372 listed companies that fall under the Investment Act of 1940 as a benchmark index. We obtain this sample by collecting closed-end funds from CRSP.[25] We only include those events that occur after it became absolutely clear that companies registered under the Investment Company Act of 1940 would be exempt from the exclusion of broker discretionary voting in uncontested director

[25] Closed-end funds have a CRSP share code of 14.

elections, which happened on May 23, 2007, when the SEC filed the Amendment to the proposed rule outlining the exemption.

In Panel D, we find a negative overall wealth effect that is weakly statistically significant. When we examine the events separately in Panel E, we find only a statistically significant effect for event 8, relating to the date that the rule was put up for comments. The effect of this event on abnormal stock returns is negative. Note that this event occurs in 2009, i.e. after implementations of broker proportional voting, and in a year in which markets were very volatile and many crisis-related announcement were made. We list potentially confounding events on our event dates in Table V.

[Table V here]

The potentially confounding events are based on the Business & Finance section of the Wall Street Journal on the day after the event, which provides a short discussion of the market's performance on the previous day. Of course, there is always some news on a particular day, and the events reported in Table V are not necessarily problematic for our study if they affect both our control groups and firms on the S&P 500 in a similar manner. It can however be seen that on several days there are confounding events that are likely to affect the firms in our sample differently than the firms in our control groups, like bank-related government interventions on event #8. We therefore have to be careful in drawing strong conclusions from the wealth effects on a single event in 2009.

[Table VI here]

In Table VI we consider alternative event windows. We find no significant overall wealth effects on days [0, 1], [0, 3] and [-15, 1] around the events. Overall, our main conclusion is that there is no strong evidence that the change in Rule 452 was either value decreasing or value increasing for shareholders.

VII. Cross-Sectional Effects and Abnormal Returns for Small Firms

Although overall wealth effects might be insignificant, a subsample of firms may be affected by the change in Rule 452. In this section, we examine this possibility in three ways. First, we examine the impact of firm characteristics on the cross-sectional abnormal returns on event days. Second, we examine the relation between abnormal returns and the percentage of investors that actively support the rule change. Third, we examine the abnormal returns of a sample of small cap firms.

A. Cross-sectional effects

The change in Rule 452 is not likely to affect all firms to the same extent. For example, firms with relatively low percentages of broker discretionary votes are likely to be relatively unaffected by the rule change, whereas firms with high percentages of broker discretionary votes should expect stronger effects. We examine the effect of eight variables on the cross-sectional abnormal returns during the nine events related to a change in Rule 452. These variables are the following:

Percentage of broker discretionary votes. The change in Rule 452 is likely to be more relevant

for firms with a higher percentage of broker discretionary votes.

Approval rate. We predict that the change in Rule 452 is more relevant for firms in which average approval rates are low, since the likelihood of a director being voted off the board is higher for these firms.

Institutional ownership. When controlling for the percentage of broker discretionary votes, firms with high institutional ownership are more likely to be affected by the rule change since the elimination of the broker vote facilitates the exertion of "voice" by institutional investors, for instance, through vote no campaigns.

Majority voting. For a given percentage of approval votes, the probability of a director being removed from the board is highest with a majority voting standard and lowest with a plurality voting standard, with the plurality-plus-resignation voting standard being in between.

Entrenchment index. The empowerment of shareholders is likely to be more relevant for firms in which shareholder rights are currently relatively low, which is indicated by a relatively high score on the entrenchment index.

Return on assets. The impact of the rule change is higher when the probability of shareholder activism is higher, which is more likely when the firm is performing poorly.

Firm size. Several comment letters argue that especially small firms will be affected by the rule change, as they would have to expend a disproportionate amount of additional resources to solicit shareholder votes to obtain a quorum.

Industry competitiveness. The relevance of the rule change can depend on the availability of alternative governance mechanisms, like industry competitiveness. Giroud and Mueller (2010) and Huang and Peyer (2011) suggest that standard governance mechanisms such

as boards or takeovers might not matter for firms in industries with high product market competition.[26]

For cross-sectional analyses, Sefcik and Thompson (1986) provide a weighting procedure that controls for cross-correlation and cross-sectional heteroskedasticity in firm residuals. We follow their procedure and form a matrix *F* that has a column of ones and *P-1* columns of characteristics. In our case, *P* equals nine as we examine eight firm characteristics. We then form *P* sets of portfolio weights and compute the portfolio returns for each set of weights as follows:

$$W = \begin{bmatrix} W_1' \\ W_2' \\ \vdots \\ W_P' \end{bmatrix} = (F'F)^{-1}F' \qquad (3)$$

where W = P *x* N matrix of portfolio weights

W_p' = p^{th} row of portfolio weights

F = N *x* P matrix; $F = [1\ X_2\ X_3 \ldots X_P]$

We obtain the return on portfolio *p* on day *t* by $R_{pt} = W_p' R_{it}$, in which R_{it} is an *N x 1* vector of individual firms' stock returns on day *t.* Finally, we run *p* portfolio time-series regressions by using Equation 2. We use the global index as the benchmark, thus including lead and lagged returns, and consider all nine events. The estimates from the regressions reflect the

[26] Giroud and Mueller (2010) study the introduction of anti-takeover legislation and find that it does not affect the performance of firms in competitive industries. Huang and Peyer (2011) show that the introduction of the NASDAQ/NYSE independent board requirement following Sarbanes-Oxley has no effect on the value of firms in competitive industries.

effect of each firm characteristic on the market reaction to each event, while controlling for the effects of other firm characteristics.

[Table VII here]

Table VII reports the results. We use four different event windows. For the [-1, 1] event window, we do not find that firms with relatively high percentages of broker discretionary votes have different abnormal returns around Rule 452 event dates than firms with relatively low percentages of broker discretionary votes. In fact, very few of the variables that we examine have a statistically significant effect on the abnormal returns during the period [-1, 1]. These findings are in line with the relatively small value relevance of Rule 452, although we have to acknowledge the possibility that confounding events on our event dates create noise in our wealth effect analyses.

When considering alternative event windows, we again fail to find strong effects of most of our variables. Only one variable has a statistically significant impact at the 5% significance level: we find a negative effect of institutional ownership on the abnormal returns during the event window [-1, 1]. This finding would be in line with firms that are potentially more affected by the change in Rule 452 having more negative wealth effects. However, given that this result is not corroborated by the other variables in our model, we have to conclude that overall we find little evidence of the change in Rule 452 being value relevant.

B. Activist investors supporting the rule change

A number of investors have written comment letters to the SEC to support the elimination

of broker votes in uncontested director elections. In this subsection we examine whether these investors' shareholdings are informative on whether the change in Rule 452 is value relevant. After examining all comment letters, we obtain seven investors that specifically expressed their support of the rule change. These are California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS), State Board of Administration of Florida (SBA), Hermes Fund Managers (Hermes), Colorado Public Employees' Retirement Association (Colorado PERA), Teachers Insurance and Annuity Association and College Retirement Equities Fund (TIAA-CREF), and Ohio Public Employees Retirement System (OPERS). We obtain the shareholdings of these investors from the Thomson Reuters' 13-F filings database. When combining the shareholdings of the seven activist investors, we find that they have shareholdings in all 457 firms. The average combined ownership is 0.87%, with a minimum of 0.34% and a maximum of 1.69%.

We examine whether the combined shareholdings are correlated with the abnormal returns around event dates. We include the percentage of activist ownership into the cross-sectional analysis of Section VII.A, and find no statistically significant relation between the percentage ownership of the seven activist investors and abnormal returns on event dates (the coefficient is 10.286 and the *p*-value is 0.618).[27]

As a second test we examine the determinants of firms' investors explicitly expressing their support for the rule change. Of particular interest is whether shareholders of firms with relatively high percentages of broker votes are more likely to support the rule change. We use regression specifications in which activist ownership is the dependent variable, and the

[27] Instead of the percentage ownership by the seven activist investors (i.e. the combined ownership of all seven activist investors), we have included the number of activist investors per firm, the maximum percentage by a single activist investor per firm, and the average ownership of the seven activist investors per firm. Our results are robust to these different measures of activist ownership.

percentage of broker votes is one of the explanatory variables. We examine both the combined shareholdings of activist investors in a firm and the number of activist investors in a firm, and cluster standard errors by two-digit SIC codes. Table VIII shows the results.

[Table VIII here]

Model 1 of Table VIII shows that firms with higher percentages of broker votes in 2009 have a larger percentage of shareholders that explicitly express their support for the rule change. Model 2 shows that the percentage of broker votes is also positively related to the number of shareholders in a firm that explicitly express their support for the rule change. These findings are interesting as they suggest that investors who believe that broker votes should be eliminated are actually investing more in firms that have relatively high percentages of broker votes. The findings are in line with investors becoming activists when they feel they have most to gain from activism, similar to confrontational activism campaigns by hedge funds that buy large stakes in a publicly held corporation with the intention to bring about change and thereby realize a profit on the investment (see for example Klein and Zur, 2009).

C. Small firms

Table VII shows no significant relation between firm size and changes in a firm's wealth when the rules regarding broker discretionary voting change. All firms in our sample are however relatively large, which follows from our choice to focus on S&P 500 firms. Several comment letters refer to the potential importance of the change in Rule 452 for relatively small firms. For example, a letter by American Express Company states: "removing the broker vote for

the thousands of newer and smaller companies that have high percentages of retail ownership will create significant difficulties for those companies in conducting their shareholder meetings in an environment of low retail voting activity. It will likely increase the costs of uncontested elections as these companies will have to spend more money and effort to reach retail holders to urge them to vote and it will shift disproportionate weight to institutional investors or special interest groups who may have their own agendas."

[Table IX and X here]

We examine overall wealth effects for the 600 firms in the S&P Small Cap Index in Tables IX and X.[28] Table IX shows the results with event window [-1, 1] and Table X shows the results with alternative event windows. We find an overall effect in Table IX that is negative but not statistically significant at the 10% level with the global index, but that is statistically significant at the 10% level with the investment company index as a benchmark. This provides weak evidence that the marginal investor of the firms in the small cap index views the change in Rule 452 as costly. Again, however, this result appears mostly driven by event 8, as Panel B and D of Table IX show that other events have no significant wealth effects. In addition, the alternative event windows, as reported in Table X, provide no evidence for a wealth effect of the change in Rule 452 on small firms.

As a final test, we examine the voting outcomes for small firms. We choose 100 firms from the 600 firms in the S&P small cap index by first deleting all firms with classified boards at the 2009 fiscal year-end (leaving 257 firms), and then selecting those 100 firms with the highest

[28] The typical firm's total asset size at the 2009 fiscal year-end for this sample is $768 million.

percentage of non-institutional ownership, as we expect that the percentage of broker non-votes will be high in these firms. For this relatively small sample, we collect data from 2006 to 2011, to also test whether voting outcomes are changing over longer time periods, without relying too much on the 2009 fiscal year. We have 80 firms with data in all of these years, and the results for these firms are shown in Table XI.

[Table XI here]

Approval rates are also high for small firms. In most years, the average approval rate is close to 95%. Note that we observe the lowest average approval rate in 2009, with a percentage of 92.6%. In 2010 we observe the highest percentage of directors receiving a minority of votes, when 1.5% of directors fail to obtain a majority of votes. But we do not find strong evidence that voting outcomes are significantly different before and after the change in broker discretionary voting. We do find convincing evidence that firms are increasingly putting auditor ratification items on the ballot: in 2006 only 72% of the firms ratify their auditor, whereas this percentage is almost 99% in 2011.

VIII. Conclusion

Many current attempts to reform financial markets presume that shareholder empowerment is in fact beneficial to shareholders. One recent change in regulation that empowers shareholders is the elimination of broker voting in uncontested director elections. This change occurred after pressure from shareholder activists, proxy advisory firms, and the New York Stock Exchange, and removes votes that brokers would typically cast in favor of management.

We contribute to the literature on the effects of governance regulation by examining voting outcomes, no vote campaigns, and items on the ballot after the change in regulation. We further contribute to the literature by examining overall and cross-sectional wealth effects on the dates that new information on broker voting regulation was released to the market. Besides analyzing overall effects, we thus also consider those firms that are expected to be mostly affected by the rule change. Overall, we do not find a convincing effect of the rule change on shareholder value, not even for those firms that seemed to be mostly targeted by the new rule. Moreover, the probability that a particular director would be voted off the board has not increased since the rule change.

One potential explanation for these findings is that the elimination of broker voting is just one step in the direction of increasing shareholder power in the director selection process, which is insufficient in isolation. An additional step that has been increasing in popularity is the implementation of a majority voting standard. A next step that arguably needs to be taken is the education of (retail) investors, as the low impact of the rule change may be due to poor voter turnout caused by a lack of awareness or information on the part of retail shareholders. In the end, shareholder empowerment is not only about changing regulations, but about the percentage of investors actually making the effort to voice their opinions by voting. However, given the absence of wealth effects for even those firms in which we expect the strongest impact of the new rule, it appears that shareholders do not view the elimination of broker votes as an important first step, and are not convinced that other, more value relevant, steps will be taken.

Another potential explanation is that the SEC, the NYSE, shareholder activists, and proxy advisory firms believed they acted in the best interest of investors but simply misjudged the effectiveness of the regulation ex-ante. Our finding that activist investors own more shares in firms

with higher percentages of broker votes is in line with this explanation, as activist investors might have expected the strongest effects in these firms. A strong argument against this explanation is the simplicity with which one can calculate the small effect that eliminating broker votes would have on the historically very high approval rates. We find that excluding broker votes, which in our sample represent 12% of the votes cast in 2009, would decrease the average approval rate by only one percent.

A more plausible explanation for our findings is that broker votes are not of substantial importance and that outside pressure has been an important factor in the SEC's decision to change regulation. A desire of proxy advisory firms and shareholder activists to demonstrate vigilance could explain why they strongly supported the change in regulation, even if this change was unlikely to be effective. Our findings show that recent discussions about for example the elimination of broker non-votes in say-on-pay votes would appear to be unwarranted. Our results suggest that it is of interest to study in more detail the incentives and potential biases in decision making within the SEC, the NYSE, shareholder activists, and proxy advisory firms.

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Figure 1.

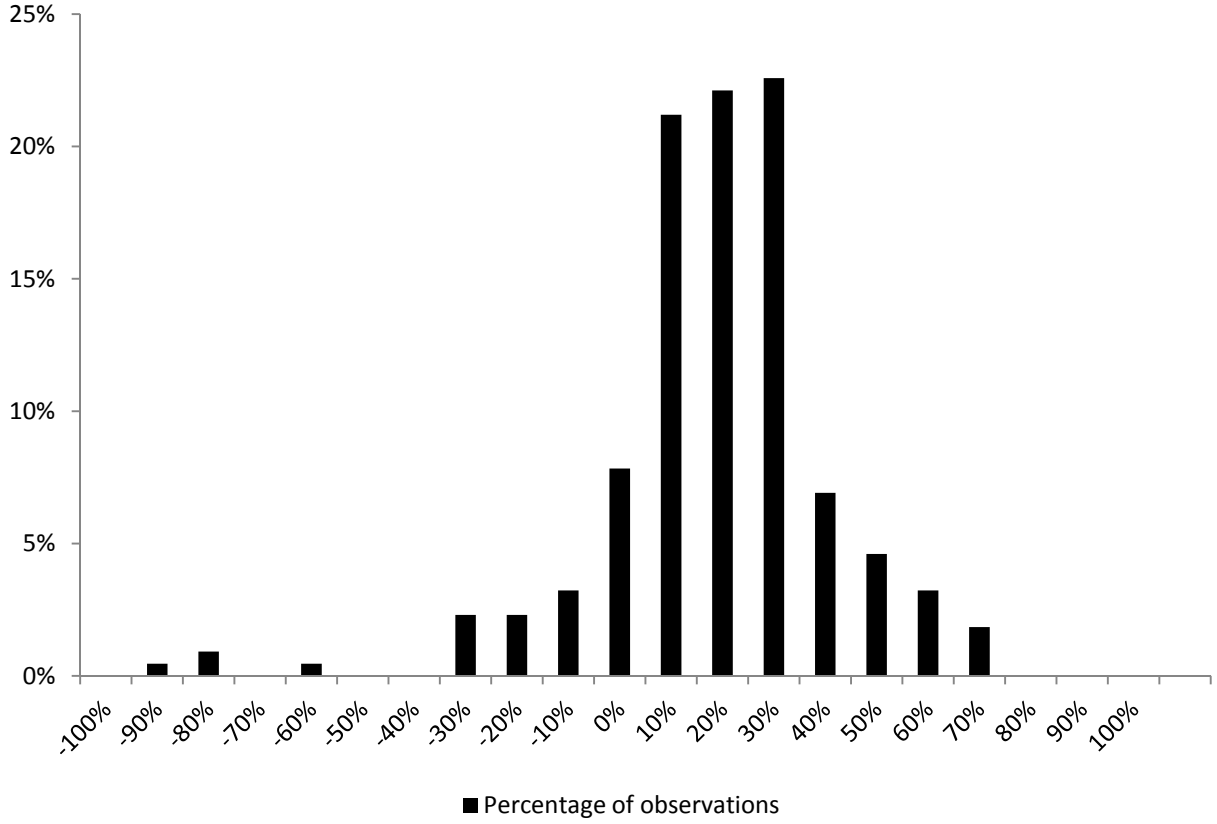

Figure 1. Histogram of the percentage of non-instructing shareholders voting after the rule change.

This figure shows a histogram of the estimated percentage of non-instructing shareholders before the rule change that vote after the rule change. The horizontal axis represent the bins. The vertical axis represents the percentage of our observations that falls in a particular bin.

Table I. Events Related to Broker Voting

This table presents an overview of important regulatory and legislative events related to broker voting. The events are obtained by an extensive search in Factiva, Google, and the SEC's website. The last column reports whether the event increases or decreases the likelihood of federal proxy access regulation.

Event #	Event Date	Event Description	Regulation Likelihood
1	July 30, 2003	Broker voting lands on the SEC's radar screen	Increases
2	November 17, 2004	Early Dow Jones Newswire	Increases
3	April 25, 2005	First NYSE Working Group meeting	Increases
4	June 5, 2006	Recommendations of Working Group published	Increases
5	October 24, 2006	Rule proposed to the SEC	Increases
6	September 28, 2007	Reports on postponement	Decreases
7	May 21, 2008	Press reports about proposal being stuck	Decreases
8	February 26, 2009	Rule published for comment by SEC	Increases
9	July 1, 2009	Rule approved by SEC	Increases

Table II. Summary Statistics

This table presents summary statistics for our sample of 457 firms. The data are from the 2009 fiscal year. Votes cast are reported in millions of votes. Percentage of discretionary broker votes is the number of discretionary broker votes divided by total votes cast. The approval rate is the percentage of votes being in favor of a director. We calculate the average approval rate per firm. The synthetic approval rate is the percentage of votes being in favor of a director when broker discretionary votes would not have counted. We calculate the average synthetic approval rate per firm. The synthetic decrease in approval rate is the approval rate minus the synthetic approval rate. Firm size is total assets and is reported in millions of dollars. Return on assets is measured by the ratio of operating income before depreciation to total assets. Institutional ownership is the proportion of outstanding shares held by institutional owners at the end of 2009. The entrenchment index counts the number of provisions a firm has out of the following six: staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments. The Herfindahl-Hirschman index is the sum of the squared market shares of firms based on three-digit SIC codes. Majority voting equals one for a majority voting standard, zero for a plurality voting standard, and 0.5 for a plurality-plus-resignation voting standard.

	Mean	Median	Standard Deviation	Minimum	Maximum
Total votes cast (in millions)	554	246	1,077	11	12,409
Percentage of discretionary broker votes	0.121	0.107	0.065	0.001	0.441
Approval rate	0.931	0.960	0.082	0.490	0.997
Synthetic approval rate	0.921	0.953	0.093	0.429	0.996
Synthetic decrease in approval rate	0.010	0.005	0.014	0.000	0.110
Firm size (in millions $)	52,559	11,848	194,279	680	2,223,299
Return on assets	0.128	0.118	0.088	-0.242	0.655
Institutional ownership	0.847	0.865	0.132	0.312	1.000
Entrenchment index	3.562	3.000	1.183	0.000	6.000
Herfindahl-Hirschman index	0.187	0.148	0.173	0.019	1.000
Majority voting	0.663				

Table III. Voting Outcomes for the Period 2009 – 2011

This table presents voting outcomes for a sample of 407 firms for which we could find voting results in 2009, 2010, and 2011. We report the averages per year. The approval rate is the percentage of votes being in favor of a director. The percentage of directors receiving a minority of votes is the average of the number of directors receiving less than 50% favorable votes divided by the number of directors on the ballot over all firms. Votes cast are reported in millions of votes. The percentage of vote no campaigns is the percentage of firms with a vote no campaign against one or more of its directors. The percentage with auditor ratification on the ballot is the percentage of firms that include the ratification of the auditor on the ballot. In Panel D we only consider those 228 firms that do not have a classified board. Difference of means *t*-statistics relate to the difference between 2009 and the period 2010-2011, with equal variances not assumed. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

	2009	2010	2011	Difference of means *t*-statistic
Panel A: Approval Rates				
Approval rate	0.928	0.949	0.952	-4.710***
Number of directors on ballot	7.826	8.079	8.233	-1.383
Percentage of directors receiving minority of votes	0.545%	0.019%	0.386%	1.076
Total votes cast (in millions)	537	495	492	0.683
Panel B: Vote No Campaigns				
Percentage of vote no campaigns	0.737%	1.720%	0.246%	-0.449
Panel C: Items on Ballot				
Number of items on ballot	3.894	3.931	5.602	-7.193***
Percentage with auditor ratification on ballot	0.975	0.993	0.988	-1.717*
Panel D: Firms without a Classified Board				
Total votes cast (in millions)	745	682	678	0.588
Approval rate	0.939	0.954	0.958	-3.503***
Number of directors on ballot	10.711	10.702	10.724	-0.012
Percentage of directors receiving minority of votes	0.388%	0.034%	0.031%	1.584

Table IV. Wealth Effects of Changes in Rule 452

This table presents daily abnormal returns around events related to changes in the rules for broker discretionary voting. The event window is [-1, 1]. In Panel A, we report overall daily abnormal returns of our sample of S&P 500 firms on the nine event dates as reported in Table I, with a global index (the Dow Jones Global Ex. U.S. index) as benchmark. In Panel B, we report the abnormal returns per event. Panel C shows the overall wealth effects before and after March 2007 with the global index as a benchmark. Panel D and E show daily abnormal returns when we use the returns of companies registered under the Investment Company Act of 1940 as a benchmark. We report the overall daily abnormal returns in Panel D and the daily abnormal returns per event in Panel E. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

Panel A. Overall Wealth Effects

	Global Index	
	Coefficient	*p*-value
Daily abnormal return	-0.001	0.804
Market return (t)	0.581***	0.000
Market return (t-1)	-0.157***	0.000
Market return (t+1)	0.532***	0.000
Intercept	0.000	0.407

Panel B. Wealth Effects per Event

	Likelihood	Global Index	
		Coefficient	*p*-value
Event #1	Increases	0.003	0.681
Event #2	Increases	-0.002	0.752
Event #3	Increases	0.000	0.964
Event #4	Increases	0.004	0.594
Event #5	Increases	0.001	0.931
Event #6	Decreases	-0.002	0.798
Event #7	Decreases	-0.002	0.736
Event #8	Increases	-0.010	0.133
Event #9	Increases	-0.004	0.539

Panel C. Overall Wealth Effects before and after March 2007

	Global Index			
	Before March 2007		After March 2007	
	Coefficient	*p*-value	Coefficient	*p*-value
Daily abnormal return	0.000	0.877	-0.002	0.604
Market return (t)	0.473***	0.000	0.626***	0.000
Market return (t-1)	-0.074***	0.008	-0.191***	0.000
Market return (t+1)	0.430***	0.000	0.567***	0.000
Intercept	0.000	0.667	0.000	0.682

Panel D. Overall Wealth Effects after May 23, 2007

	Investment Company Index	
	Coefficient	*p*-value
Daily abnormal return	-0.006*	0.096
Market return (t)	1.149***	0.000
Intercept	0.000	0.668

Panel E. Wealth Effects per Event

	Likelihood	Investment Company Index	
		Coefficient	*p*-value
Event #6	Decreases	0.001	0.916
Event #7	Decreases	-0.005	0.516
Event #8	Increases	-0.019**	0.013
Event #9	Increases	-0.010	0.168

Table V. Confounding Events

This table presents potentially confounding events, which are obtained from the Business & Finance section of the Wall Street Journal on the day after the event date.

Event date	Event #	Daily overview
July 30, 2003	1	The economy showed signs of a budding recovery led by the manufacturing sector, a Fed study of regional economies said; Stocks fell and bonds rallied to end a four-day slide. The industrials fell 4.41 to 9200.05; the Nasdaq shed 10.46 to 1720.91.
November 17, 2004	2	Consumer prices rose 0.6% in October, the largest increase in five months. The data could affect the Fed's decisions on interest-rate policy in coming months; The Dow industrials finished up 61.92 points at 10549.57 after the heating-oil news checked an earlier surge. Bond prices jumped.
April 25, 2005	3	The Dow industrials rose 84.76 points to 10242.47 on news of unexpectedly strong home sales and a drop in oil prices to $54.57.
June 5, 2006	4	The Dow Industrials tumbled 199.15 points, or 1.77%, to 11048.72 after an inflation warning by Bernanke stoked fears of further rate increases. The Nasdaq slid 2.24% to 2169.62. Treasurys also fell, pushing the yield on the 10-year note to 5.024%. Oil settled up 27 cents at $72.60 after surging earlier on an Iranian threat of a supply disruption; Fed rate increases have boosted the yields on some money-market funds and short-term Treasury bills to more than 5%, their highest level since 2001.
October 24, 2006	5	The Dow industrials set another record, edging up 10.97 points to 12127.88 in advance of the Fed rate decision; Bonds and oil prices rose.
September 28, 2007	6	The world economy may be able to cope with oil prices of $100 a barrel if certain conditions are met. Crude, meanwhile, fell $1.22, or 1.5%, to $81.66; The Dow industrials fell 17.31 points to 13895.63, but gained 3.6% for the quarter. Gold hit a 27-year intraday high, while wheat prices set a record; The Fed's preferred inflation gauge rose 1.8% in August from a year earlier, the smallest increase since February 2004.

May 21, 2008	7	Oil prices surged $4.19, or 3.3%, to a record $133.17 a barrel in New York, helping drive down the Dow industrials for the second straight day; The Dow fell 227.49 points, or 1.8%, to 12601.19; The Federal Reserve's hints that it won't further cut interest rates also weighed on stocks; The Fed lowered its expectations for the economy, reflecting the housing downturn and credit crunch as well as rising food and energy prices, April minutes showed.
February 26, 2009	8	Government intervention will allow sagging global banking titans Citigroup and Royal Bank of Scotland to remain standing. Citigroup is close to a deal for the U.S. to significantly increase its stake in exchange for boardroom changes. In London, the U.K. government agreed to pump billions of pounds into RBS, taking it to the brink of nationalization; Stocks started strong but cooled off, sending the Dow Jones Industrial Average down 1.2%, to 7182.08; Fannie Mae posted a $25.2 billion loss for the fourth quarter, and similar expectations for Freddie Mac paint a worsening outlook; Durable-goods orders plunged in January while new-home sales and data on unemployment worsened.
July 1, 2009	9	The three biggest car makers in America called a bottom to the long decline in U.S. auto sales as the industry reported its smallest monthly sales drop this year. New-vehicle sales fell 28% in June from a year earlier. Meanwhile, GM will file for an initial public offering of shares sometime next year, according to a timetable laid out in a U.S. bankruptcy court; Declines in manufacturing activity slowed last month, indicating that the sector could see growth in the second half of the year; Stocks began the quarter with gains after the latest economic news; The Dow industrials rose 57.06 points, or 0.7%, to 8504.06, led by Kraft.

Table VI: Alternative Event Windows

This table presents daily abnormal returns around events related to changes in the rules for broker discretionary voting. The event windows are [0, 1], [0, 3], and [-15, 1]. We report overall daily abnormal returns of our sample of S&P 500 firms on the nine event dates as reported in Table I when we use a global Index (the Dow Jones Global Ex. U.S. index) as benchmark, and on the last four of our events when we use the returns of companies registered under the Investment Company Act of 1940 as a benchmark. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

	Coefficient	*p*-value
Panel A: Event Window [0, 1]		
Global Index	0.002	0.531
Investment Company Index	-0.006	0.182
Panel B: Event Window [0, 3]		
Global Index	0.000	0.946
Investment Company Index	-0.003	0.382
Panel C: Event Window [-15, 1]		
Global Index	0.000	0.642
Investment Company Index	-0.001	0.468

Table VII. Cross-Sectional Abnormal Returns

This table presents the results from the cross-sectional analysis. Event parameters are based on Sefcik and Thompson (1986). We regress the abnormal returns on seven firm characteristics. Data are from the 2009 fiscal year. Percentage of discretionary broker votes is the number of discretionary broker votes divided by total votes cast. The approval rate is the percentage of votes being in favor of a director. We calculate the average approval rate per firm. Majority voting equals one for a majority voting standard, zero for a plurality voting standard, and 0.5 for a plurality-plus-resignation voting standard. The entrenchment index counts the number of provisions a firm has out of the following six: staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments. Institutional ownership is the proportion of outstanding shares held by institutional owners at the end of 2009. Return on assets is measured by the ratio of operating income before depreciation to total assets. Firm size is the natural logarithm of total assets. The Herfindahl-Hirschman index is the sum of the squared market shares of firms based on three-digit SIC codes. Coefficients are multiplied by 100. *p*-values are provided in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

	[-1, 1]	[0, 1]	[0, 3]	[-15, 1]
Percentage of broker discretionary votes	-0.167	-0.935	-0.893*	0.182
	(0.754)	(0.150)	(0.053)	(0.421)
Approval rate	-0.110	-0.117	0.215	-0.020
	(0.714)	(0.748)	(0.407)	(0.876)
Majority voting	0.015	-0.029	-0.033	-0.008
	(0.808)	(0.702)	(0.538)	(0.772)
Entrenchment index	-0.021	-0.049	-0.010	-0.011
	(0.401)	(0.110)	(0.650)	(0.303)
Institutional ownership	-0.776**	-0.833*	-0.590*	-0.043
	(0.026)	(0.051)	(0.052)	(0.774)
Return on assets	0.070	-0.475	0.018	-0.125
	(0.907)	(0.517)	(0.972)	(0.624)
Firm size	-0.012	-0.026	0.021	-0.006
	(0.807)	(0.668)	(0.627)	(0.775)
Herfindahl-Hirschman index	-0.356*	-0.159	-0.024	-0.041
	(0.085)	(0.531)	(0.894)	(0.642)
Intercept	0.960	1.625**	0.253	0.200
	(0.133)	(0.038)	(0.649)	(0.463)

Table VIII. Determinants of Shareholders Expressing their Support for a Rule Change

This table presents the results of OLS regression models estimating the relation between activist ownership and the cross-sectional variables from Table VII. Activists are investors expressing their support for eliminating broker votes in comment letters to the SEC, which are California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS), State Board of Administration of Florida (SBA), Hermes Fund Managers (Hermes), Colorado Public Employees' Retirement Association (Colorado PERA), Teachers Insurance and Annuity Association and College Retirement Equities Fund (TIAA-CREF), and Ohio Public Employees Retirement System (OPERS). The dependent variable in Model 1 is the percentage shareholdings of activist investors in a firm (in which 1% ownership gives a value of 1). The dependent variable in Model 2 is the number of activist investors in a firm. We report standard errors clustered by two-digit SIC codes in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

	Activist Ownership	Number of Activists
Percentage of broker discretionary votes	0.235**	0.976*
	(0.119)	(0.533)
Approval rate	-0.075	0.110
	(0.086)	(0.248)
Majority voting	0.012	0.185**
	(0.018)	(0.088)
Entrenchment index	0.006	-0.031
	(0.008)	(0.031)
Institutional ownership	0.509***	-0.188
	(0.116)	(0.274)
Return on assets	0.031	2.357***
	(0.098)	(0.378)
Firm size	0.013*	0.224***
	(0.007)	(0.027)
Herfindahl-Hirschman index	-0.104	0.122
	(0.082)	(0.201)
Intercept	0.340**	1.939***
	(0.146)	(0.331)
N	457	457
R^2	0.131	0.304

Table IX. Wealth effects of Changes in Rule 452 for Small Firms

This table presents daily abnormal returns around events related to changes in the rules for broker discretionary voting. The event window is [-1, 1]. In Panel A, we report overall daily abnormal returns of our sample of small cap firms on the nine event dates as reported in Table I, with a global Index (the Dow Jones Global Ex. U.S. index) as benchmark. In Panel B, we report the abnormal returns per event. Panel C and D show daily abnormal returns when we use the returns of companies registered under the Investment Company Act of 1940 as a benchmark. The events that we consider are events 6, 7, 8, and 9 of Table I. We report the overall daily abnormal returns in Panel C and the daily abnormal returns per event in Panel D. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

Panel A. Overall Wealth Effects for Small Firms

	Global Index	
	Coefficient	*p*-value
Daily abnormal return	-0.002	0.566
Market return (t)	0.529***	0.000
Market return (t-1)	-0.105***	0.000
Market return (t+1)	0.588***	0.000
Intercept	0.000	0.464

Panel B. Wealth Effects per Event for Small Firms

	Likelihood	Global Index	
		Coefficient	*p*-value
Event #1	Increases	0.009	0.290
Event #2	Increases	-0.003	0.742
Event #3	Increases	-0.004	0.640
Event #4	Increases	0.000	0.970
Event #5	Increases	0.000	0.996
Event #6	Decreases	-0.001	0.923
Event #7	Decreases	0.003	0.741
Event #8	Increases	-0.012	0.140
Event #9	Increases	-0.003	0.753

Panel C. Overall Wealth Effects after May 23, 2007 for Small Firms

	Investment Company Index	
	Coefficient	*p*-value
Daily abnormal return	-0.008*	0.091
Market return (t)	1.127***	0.000
Intercept	0.000	0.712

Panel D. Wealth Effects per Event for Small Firms

	Likelihood	Investment Company Index	
		Coefficient	*p*-value
Event #6	Decreases	0.002	0.819
Event #7	Decreases	0.000	0.999
Event #8	Increases	-0.021**	0.025
Event #9	Increases	-0.009	0.367

Table X: Alternative Event Windows for Small Firms

This table presents daily abnormal returns around events related to changes in the rules for broker discretionary voting. The event windows are [0, 1], [0, 3], and [-15, 1]. We report overall daily abnormal returns of our sample of small cap firms on the nine event dates as reported in Table I when we use a global Index (the Dow Jones Global Ex. U.S. index) as benchmark, and on the last four of our events when we use the returns of companies registered under the Investment Company Act of 1940 as a benchmark. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

	Coefficient	*p*-value
Panel A: Event Window [0, 1]		
Global Index	0.002	0.606
Investment Company Index	-0.005	0.237
Panel B: Event Window [0, 3]		
Global Index	-0.002	0.512
Investment Company Index	-0.005*	0.094
Panel C: Event Window [-15, 1]		
Global Index	0.001	0.649
Investment Company Index	-0.001	0.298

Table XI. Small Firms' Voting Outcomes

This table presents voting outcomes for a sample of 80 small cap firms for which we could find voting results from 2006 until 2011. We report the averages per year. Votes cast are reported in millions of votes. The approval rate is the percentage of votes being in favor of a director. The percentage of directors receiving a minority of votes is the average of the number of directors receiving less than 50% favorable votes divided by the number of directors on the ballot over all firms. The percentage with auditor ratification on the ballot is the percentage of firms that include the ratification of the auditor on the ballot. Difference of means *t*-statistics relate to the difference between the period 2006-2009 and the period 2010-2011, with equal variances not assumed. ***, **, and * indicate significance at the 1%, 5%, and 10% significance level, respectively.

	2006	2007	2008	2009	2010	2011	Difference of means *t*-statistic
Approval rate	0.949	0.953	0.938	0.926	0.941	0.948	-0.359
Number of directors on ballot	7.734	7.627	7.692	7.795	8.063	8.183	-1.789*
Percentage of directors receiving minority of votes	0.543%	0.133%	0.855%	0.362%	1.512%	0.376%	-0.836
Total votes cast (in millions)	31	33	34	37	33	38	-0.651
Number of items on ballot	2.430	2.347	2.646	2.684	2.600	4.521	-7.832***
Percentage with auditor ratification on ballot	0.722	0.800	0.873	0.924	0.963	0.986	-5.734***